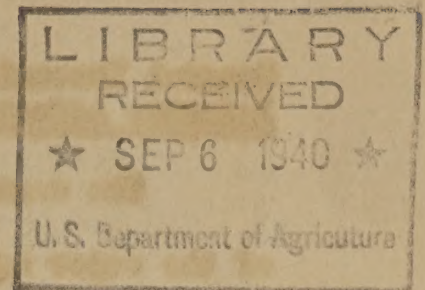


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UNITED STATES DEPARTMENT OF AGRICULTURE  
Agricultural Adjustment Administration  
Sugar Division



PROCESSOR-GROWER RELATIONS IN THE BEET  
SUGAR INDUSTRY

Address of Charles M. Nicholson, Sugar Division, before  
American Institute of Cooperation, Michigan State College,  
East Lansing, Michigan, on July 11, 1940.

The producer of sugar beets is much more closely in touch with the processor of his product than is the producer of most other agricultural crops. This is in all probability the result of the tremendous importance to the processor of maintaining volume but not in excess of the capacity of the plant, the definitely great hand labor requirements of the crop, the technical skill required in its production, and the necessity of maintaining adequate farm practices. Although sugar beet companies are not as active in the procurement of labor for production, cultivation and harvest as was the case some years ago, these concerns still take much of the responsibility of providing producers with adequate labor supplies, settling minor disputes between producer and laborer, measuring acreage in order to calculate wage payments (which are predominantly on a piece rate basis) and offering technical advice to the farmer. These functions are performed by a force of "field men" who are in more or less continuous contact with producers. Needless to say, with an organizational structure such as this, the association between processor and producer is very close except in fields in which their interests conflict.



General Economic Characteristics of the Beet Sugar Industry Affecting the Processor-Grower Relationship

The sugar beet crop is not sold in central markets, as are many of the major agricultural crops, but is produced and sold in accordance with the terms of purchase agreements entered into between the producer and processor at a date prior to the normal planting season. The producer finds this arrangement desirable in order that he may have a certain market for his product on a predetermined price basis and in order that he may obtain the protection afforded by contractual provision for proper tare analysis, sucrose analysis, weighing and similar factors which affect his returns. For much the same reasons and to have assurance of an adequate volume, the processor finds the contract system the only one possible.

This crop is both bulky and semi-perishable so that it cannot be transported for great distances nor can it be stored cheaply and safely for long intervals of time. At the same time the initial outlay necessary for the construction of a processing plant is so great that, like the utility enterprises, the duplication of facilities within a single territory is uneconomic. Any inadequacy of raw material supplies resulting from the over-building of processing facilities or other causes tends to reduce the annual period of operation, thereby increasing the unit cost of manufacture substantially. For these reasons the only market available to the producer is ordinarily the plant of a single buyer, the processor having, in some degree, a buyer's monopoly. Largely because of the semi-monopolistic nature of the processing business, the terms of the purchase agreement have been the center of controversy



between the grower and processor. One other feature of the industry, namely, its extreme dependence upon public protection in some form is perhaps responsible for a part of the controversy over the grower-processor relation. The degree of this protection has been relatively large during recent years as a result of the fall in the world price of sugar. Growers feel that the public protection is maintained primarily for their benefit and that profits for processors above an amount necessary to maintain plants is unjustified, while some processors feel that the very risk of dependence upon government protection calls for the establishment of financial reserves to meet conditions which may arise through unfavorable legislation or other causes which might make it impossible for a processor to continue in operation without such reserves.

At the present time associations of growers organized for the purpose of collective action bargain as a unit for their individual members. These organizations enjoy varying degrees of bargaining strength depending upon the nature of local laws governing cooperative marketing associations, the leadership, the composition of the membership, and other factors.

#### The Market for Sugar Beets

The sugar industry is at the present time protected by a system of quota controls, an excise tax, and a conditional payment structure, which, in contrast with a tariff structure, bring a portion of the protection into the open. Basic requisites of an effective scheme of quota control consist of an adequate, impartial system for the allocation of the quotas to those who market sugar, and a plan under which production



will be maintained at quota levels. The latter requisite is secured by requiring that the producer, in order to qualify for a conditional payment, produce not more than the "proportionate share" for his farm of the quantity required to fill the quota for the area of which it is a part and to provide a normal carryover inventory. The "proportionate shares" for farms are determined, to use the language of the Sugar Act of 1937, by taking: ".....into consideration the past production on the farm of sugar beets and sugarcane marketed (or processed) for the extraction of sugar or liquid sugar and the ability to produce such sugar beets or sugarcane, and the Secretary shall, insofar as practicable, protect the interests of new producers and small producers and the interests of producers who are cash tenants, share-tenants, adherent planters, or sharecroppers."

The quota for any domestic area is allotted only after public hearing and in conformity with the standards set forth in the Act which provides in part that: "Allotments shall be made in such manner and in such amounts as to provide a fair, efficient and equitable distribution of such quota or proration thereof by taking into consideration the processings of sugar or liquid sugar from sugar beets or sugarcane to which proportionate shares, determined pursuant to the provisions of subsection (b) of Section 302 pertained; the past marketings or importations of each such person; or the ability of such person to market or import that portion of such quota or proration thereof allotted to him....."

It will be noted that it is required that the allocation of the quotas be based upon the historical record of each firm. In the continental areas marketing allotments, calculated by giving 75 percent weight to



processings from proportionate share acreage for the calendar year immediately preceding that for which the allotment was made, and 25 percent weight to the history of past marketing, have been found to result in a fair, efficient and equitable distribution of the quota. The quota of the beet area for 1940 was allocated in conformity with a stipulation and agreement reached by the interested persons.

If any person feels himself aggrieved by the provisions of any allotment order, the Act provides that he may appeal to the United States Circuit Court of Appeals for the District of Columbia. There has been one such appeal in the continental area which originated in Louisiana. In this case, an allotment was requested for a factory which had been idle for a period of approximately ten years. Under the formula indicated above the organization was ineligible for an allotment so its request was denied. After review of the case the Court sustained the order of the Secretary.

In view of the nature of the legislation it is obvious that a new processing organization could never be assured of an allotment in advance of a hearing as the decision and order allotting the quota must be based upon evidence developed in the record. The final decision of the Department of Agriculture, should a contest develop, is always subject to review by the Court. In these circumstances the market for sugar beets is, within limits, restricted to those firms now engaged in processing sugar beets.

Sugar Legislation and the Distribution  
of the Income of the Beet Sugar Industry

On several occasions preceding the enactment of the Sugar Act of 1937, the problem of grower-processor relations was the subject of



investigation. The Commissioner of Corporations, at the direction of the Secretary of Commerce, began an investigation covering the period 1909-1914. This investigation, dealing largely with costs, was completed by the Federal Trade Commission and its results published in 1917. During the World War, early in the history of the Food Administration, local commissions were established to deal with the problem of sugar beet prices. These commissions summoned witnesses, conducted examinations and recommended prices. The Jones-Costigan Act of 1934 carried a provision authorizing the Secretary of Agriculture to adjudicate disputes as to the terms of purchase of sugar beets.

The Sugar Act of 1937 provides that a producer who is also a processor must pay fair and reasonable prices for sugar beets if he is to qualify for the conditional payments authorized in that legislation. In the above connection, it is worthy of note that unlike the processor of sugarcane the typical sugar beet processor is not a producer of sugar beets and consequently is not an applicant for conditional payments. The Act also authorizes the Secretary of Agriculture to make recommendations relative to the terms of purchase agreements between processors and producers.

Current sugar legislation represents a new departure in that the distribution of income in this protected industry is subject to a degree of control. The contracts used throughout the industry for the purchase of sugar beets are of the so-called participating type. The payment received by the producer for his sugar beet is dependent upon two factors, the sugar content of the beet and the net return realized from the sale of sugar. In the area east of the Mississippi River the grower receives



a price per ton of beets equal to one-half the value of the products produced therefrom, while in the west payment is based upon sucrose tests. In the latter case the price paid reflects the value of approximately one-half of the sugar recoverable under certain assumed conditions of efficiency.

How does the control system work? The price for refined sugar is determined by the supply of and demand for the product. Under a quota plan the immediate supply made available to the market is determined by the government. The level of price results from the relationship of that supply to the demand situation. The imposition of an excise tax under these circumstances reduces the "net return" derived from the sale of beet sugar by an amount equal to the tax. The amount available to the processor from the market being reduced in an amount roughly equivalent to the tax and as he retains approximately one-half of the market proceeds, his income is reduced by one-half of the tax.

The payment received by the producer from the processor likewise declines, but the decline is much more than compensated by the conditional payment received from the government.

To illustrate, if a quota system were operative which would result in a net return from the sale of beet sugar of \$3.75 per hundred-weight, the producer would receive a return per ton, under the purchase agreement in use in one of the important producing areas, of \$5.19 per ton on a 16 percent sucrose content beet. With other factors constant, the imposition of a 53.5 cent tax per one hundred pounds, refined value, (equivalent to 50 cents per hundred pounds, raw value) would reduce



the net return" to \$3.215 and the grower would receive \$4.36 per ton of beets from the processor, but, in addition, he would receive a government payment, if the conditions governing the receipt of such payments have been met, of \$1.83 per ton or a total income of \$6.19 per ton. In other words, the income of the producer is in these circumstances increased by \$1.00 per ton while that of the processor is reduced by approximately 75 cents per ton of beets processed.

Alternative Concepts of Fair and Reasonable Sugar Beet Prices

This analysis brings us back to the provisions of the Sugar Act which permit the Secretary of Agriculture to recommend terms of these purchase agreements. Public hearings with respect to the problem of fair and reasonable prices for sugar beets have been held in the domestic beet sugar producing area. As a result of these hearings, it appears that at least three points of view have attained prominence. Some growers advocate the so-called flat-rate contract under which the producer would receive a stipulated predetermined price for each ton of sugar beets delivered, without regard to the quality of the sugar beet or the price of sugar. Under this type of contract risks of price and quality would be borne by the processor. As recompense for the assumption of these risks, the processor, as has been the case historically, would probably insist upon the maximum profit available by bidding for beets at rates no higher than are necessary to induce the production of this crop in preference to alternative crops.

It is obvious that the processor must pay a price which will afford a return to the grower sufficient to induce him to bear the special burdens which go with sugar beet production and to afford a return at



least as great as that available from the production of other commodities. However, if the public protection afforded the industry is in excess of that afforded other crops, the processor may, if his bargaining powers are sufficient, secure for himself through the terms of the purchase agreement, any income in excess of that available from non-protected alternative crops. In some instances exceedingly large financial surpluses have been accumulated by those processors having exceptionally low costs or other advantages. Conversely, if the protection afforded the industry is inadequate to cover total costs and alternative crops are sufficiently attractive or if their costs are relatively high, processors may be forced to assume losses and in the past large losses have been incurred by some processors.

Closely akin to the flat-rate type of contract is the participating contract containing a minimum guaranteed price per ton of sugar beets. The effect of such a type of contract is to place additional risks upon the processor while permitting only a limited degree of participation in the benefits of higher levels of price.

Others argue in support of a cost-of-processing basis. Under such a system of price determination for sugar beets, the processor would be assured of his costs, everything left over accruing to the grower. All of the risks of price, quality and volume, if such a principle were adopted, would fall on the grower. The normal competitive incentives toward improvement of technical efficiency and cost reduction would probably not operate with vigor in such circumstances. In fact, the incentives might be such as to lead to inflation of cost items.



The principle which appears to have found the greatest support is the so-called participating basis. Under this type of purchase contract the "net return" realized from the sale of the sugar as well as the quality of the beet are factors in the price settlement. It is apparent that there exist two definite limits to price. It is obviously impossible for the processor to secure an adequate supply of sugar beets unless he pays a price at least sufficiently high in competition with other crops to induce growers to produce beets. It is equally apparent that the grower cannot secure a price for sugar beets in excess of that represented by the processors' ability to pay. The margin or zone between these two limits may be small in certain districts at certain times. In other instances it may be large. Within these limits lies the problem of the development of an acceptable standard or group of standards which may be employed to effect a participating distribution of the available income. A number of standards such as relative costs, relative investments, relative hazards of the two groups, and equality of opportunity in making profits, have been suggested. Each is open to some objection.



GROWER-PROCESSOR INCOME IN RECENT YEARS

Year In Which Fiscal Year Ended	Net Income of Proces- sors After Taxes	Net Income as Percent of Average Net Worth	Crop Year	Percentage of Total Beet Crop Processed By Companies Included	Farm Income Per Ton Of Sugar Beets
			<u>1/</u>		<u>2/</u>
1930	\$4,065,037	2.58	1929	97.53	\$7.08
1931	- 9,178,255	- 6.29	1930	96.63	7.14
1932	- 7,813,129	- 5.84	1931	94.56	5.94
1933	2,430,439	1.85	1932	94.29	5.26
1934	13,560,497	11.08	1933	88.45	5.13
1935	14,183,136	11.11	1934	94.90	6.92*
1936	17,242,387	12.91	1935	95.29	6.89*
1937	15,989,411	12.43	1936	85.53	6.05
1938	11,588,316	8.87	1937	91.03	7.20*
1939	7,074,999	5.55	1938	84.81	6.52*
1940	7,275,050	7.00	1939	60.0	

1/ The calendar year in which the crop is grown and the fiscal period ended in the next calendar year coincide only roughly.

2/ Abandonment, deficiency, refund and soil conservation payments omitted. Asterisks indicate a government payment is included.

In examining the above table certain factors must be borne in mind. The financial result attained during a fiscal period ended in any particular year reflects the results of operations during the two preceding crop periods, fiscal years generally ending in February and March. For example, the net income indicated for the year 1940 grew out of operations in connection with the crops grown in the calendar years 1938 and 1939 since part of the 1938 and part of the 1939 crop sugar were marketed in the fiscal year ended in 1940. It should also be borne in mind that there have existed certain noteworthy differences between the sugar legislation in effect from June 1934 to January 1936, from January 1936 to September 1937 and from September 1937 to date. The first legislation provided for the attainment of parity returns to producers and for a processing tax measured by



the difference between fair exchange value and market price but not to exceed one-half cent per pound of sugar, rsw value. The legislation in effect from January 1936 to September 1937 carried no provision for conditional payments or taxes. The legislation in effect since September 1937 provides for a tax at the rate of 50 cents per hundred pounds, raw value, and for conditional payments at the rate of 60 cents per hundred pounds, raw value, a situation which differs materially with that which existed in 1934 to 1935, a period when the tax rate could exceed the conditional payment rate.

An examination of the data in the table indicate that under the current structure the income of the processing branch of the industry is smaller than that which prevailed under the first control structure, that authorized by the Jones-Costigan Act, and that the income of the grower is approximately identical. The cost to the consumer in the later period was less than during the first control period. The 1938 and 1939 crops of sugar beets exceeded the quota for the domestic sugar beet area but the emergency situation growing out of the declaration of war in Europe, which necessitated the temporary abandonment of the operation of the quota structure in the fall of 1939, did much to solve the surplus problem. The effects on the processing branch of the industry, should volume be reduced to quota levels, would probably differ from the results shown in the table.

In view of the changed distribution of income accompanying the operation of the Sugar Act, only minor modifications of the purchase agreements have been suggested. In general, for conditional payment



purposes, the established contracts have, for the first three crops to which the Act has applied, been viewed as fair and reasonable.

#### Other Factors to be Considered

Needless to say, when a commodity is sold on the basis of weight and quality, both buyer and seller are interested in seeing that these two factors are properly analyzed. In most states scales are checked as to accuracy by a state weighmaster or similar officer. For his protection the grower generally insists that contractual provision be included under which check-weighmen, check-taremen, and check-chemists may be employed to safeguard growers' interests. It appears desirable that such services be performed by growers' associations for the benefit of their membership and in order that mutual trust may be engendered.

There has been a certain amount of controversy with respect to the problem of individual tests versus factory average tests of the sucrose content of the sugar beets. It is contended by many that the sucrose content of the sugar beet is not subject to the control of the grower and that the risks of low sucrose and the benefits of high sucrose should be spread among the several growers delivering beets to a particular factory. On the other hand, many growers and processors contend that there are certain practices which lead to a reduction of the sucrose content of the sugar beet but at the same time increase the tonnage per acre. On this basis it is argued that those farmers who do not engage in the practices which lead to low sucrose should not be penalized for the benefit of those whose tonnage may be increased by these practices but whose sucrose content may be low.



Recognition must always be given to the fact that when a commodity is sold on the basis of grade, a strong incentive exists for improvement.

The method by which the "net proceeds" from the sale of sugar beets are determined is central to the contract inasmuch as that figure in conjunction with the quality of the crop determines the price to be received by the grower. There is normally included in the contract provision for audit of that figure by a firm of certified public accountants, the firm usually to be selected by the processor. The expenses which are deducted from the gross sales price include freight out, normal sales costs and all excise or manufacturing taxes. It is sometimes asserted that those items of sales costs which are subject to the control of the processor should not be treated as deductible items in arriving at the net sales proceeds since the incentive for economy is minimized when such costs are shared by the grower.

In some instances the net proceeds realized by several companies operating in a common territory are averaged in arriving at a price base for growers in the area concerned. Where this practice prevails it is defended on the ground that the averaging system distributes the risks of good and bad marketing in such a way that the grower's position is equalized each year, whereas without a system of averaging the growers served by one processor might in a particular year receive more than growers served by other processors and in another year receive less. It is also argued that if two or more processors,



dissimilar as to size of operations, are operating in a common territory the smallest operator may secure a larger percentage of local sales in high netting territory than the large processor, thereby finding himself able to pay higher prices for sugar beets to the detriment of growers served by the larger processing companies, and even to the detriment of the industry in the area since competition for the local market may result in a demoralization of the price structure within the area.

On the other side it is argued that provision for the averaging of net proceeds realized by several processors reduces competition for the supply of sugar beets. If the marketing results of one processor are consistently poorer than those of another processor, there would appear to be little justification for growers served by the processor whose marketing ability appears to be superior to suffer a reduced income; or under the principles of a participating contract, for growers served by a processor whose "nets" are low to receive an increased income. In general it may be said that growers express opposition to any system in which the average results of more than one company are employed for a settlement basis.



